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SUBJECT: Argentine Social Pacts: GoA Move to Expand Price/Wage Controls?

Ref: (A) Buenos Aires 2372

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(D) Buenos Aires 2112

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Summary

¶1. (SBU) The GoA is proposing negotiation of trilateral government, industry, and labor "Social Pacts" in ten key industry and service sectors to address public concern with rising inflation and provide a stable platform for needed new investment. President Cristina Fernandez de Kirchner (CFK) has been ambiguous in describing the role the GoA will play in facilitating negotiation of these pacts. Local analysts speculate she intends to use a Social Pact umbrella to build on her husband's interventionist economic model, expanding existing consumer basket price controls and capping wage claims for a two- to three-year period based on official 2007 inflation measures. But organized labor has already demanded wage increases of over 20% in 2008, a figure far higher than the (widely discredited) 2007 official 9% inflation rate. The government is clearly hoping to avoid costly and disruptive labor turmoil, fueled not only by inflation but also by labor union politics. Big business rejects further price controls, since their real input costs are rising faster than official inflation measures. Argentina's last experiment with Social Pact wage/price controls in the early 1970s resulted in widespread goods shortages, labor conflict, rising inflation, a sharp devaluation, and recession. Ultimately, the success of any modern-day Social Pact will depend on the convergence of interests between big business and organized labor. Any such convergence, particularly on wage negotiations, will depend on the GoA's ability to restore the tarnished credibility of official GoA inflation statistics. But even with credible inflation measures, the macro-economic policy mix that underpins Argentina's overheated growth rates will complicate GOA efforts to control economy-wide inflation over the medium term. Negotiating Social Pacts could be a costly distraction from the work needed to avoid a hard economic landing.
End Summary

Social Pacts: Ambiguous Campaign Rhetoric

¶2. (SBU) During her election appeals to private sector and union constituencies, President Cristina Fernandez de Kirchner (CFK)

hinted of plans to engineer a series of trilateral government, industry, and labor "Social Pacts" to sustain hard-won economic progress achieved over the years of post-crisis recovery. But despite repeated requests for definition from media, chambers of commerce and unions, CFK would not be drawn out during the campaign, except to say that the pacts would entail "more than just prices and wages." Later, in her December 10 inaugural address, CFK called her Social Pact proposal a push to agree on broad sector goals, with measurable and verifiable objectives that will include analyzing sector-specific competitive challenges to "determine where investment is needed and where technological innovation is required." She left ambiguous just what the GoA role would be, but did say that the GoA's role is neither to defend corporate profitability nor to interfere in union conflicts (Ref A).

Inflation: Public Concern, GoA Efforts to Cope

¶3. (SBU) Though official INDEC (GoA statistics agency) data puts annual inflation at around 9%, private estimates suggest that "real" rates are currently in the 16-20% range. (Others, including Central Bank experts, estimate true inflation somewhere between official and independent estimates.) Strong post-election increases in food, fuel, transport, health care and education prices have again raised public concerns over inflation (Ref B), and widely reported allegations that the GoA is manipulating CPI statistics to under-report official inflation have called GoA credibility into question (Ref D). Grasping for an appropriate response, GoA officials have alternated between denying inflation is a significant problem and declaring that current levels of (official) inflation are "reasonable" and in any case a tolerable byproduct of Argentina's rapid rates of GDP growth. CFK promised continued high rates of economic growth during her campaign, and anti-inflation economists and opposition politicians have repeatedly been impugned by the GoA as seeking to cool the economy at the working class's expense.

¶4. (SBU) Beyond the populist rhetoric, GoA moves to expand the GoA's primary fiscal surplus (via recently increased export taxes) should help cool inflationary pressures in 2008 (Ref C). But local and international economists agree that moderate fiscal policy alone will not serve to counterbalance the significant inflationary impetus of the GoA's broadly expansionary monetary policy. The Central Bank's accommodative monetary stance (managed via incomplete sterilization of peso emissions to fund dollar reserve accumulation) underpins (1) the GoA's commitment to maintain an undervalued peso and linked trade surplus; and (2) the GoA's effort to boost domestic investment and consumer spending via sustaining net negative real interest rates. The result: an overheated economy and too many pesos chasing relatively fixed supplies of goods and services. The consequence: growing inflation and rising inflationary expectations, an ominous development in a country with a long, painful history of hyperinflation.

Social Pacts: Segue to Expanded Economic Intervention?

¶5. (SBU) Local analysts speculate that the CFK administration will use a "Social Pact" umbrella to address inflation "the old fashioned way," by building on Nestor Kirchner's interventionist economic model, expanding existing consumer basket price controls and capping wage claims to provide a supposedly stable platform for new investment. It is generally assumed that CFK's Social Pacts will aim to fix wage and price rises over a two- to three-year period based on (discredited) official 2007 inflation measures. This will be difficult: Hugo Moyano, leader of the powerful General Labor Confederation (CGT), which groups the main trade unions, has publicly opposed including salary negotiations in Social Pacts, although this position may be intended to strengthen his negotiating hand. According to Moyano, wages should rise by over 20% in 2008, a figure far higher than the 2007 official projected 9% inflation rate and one considered excessive by both businessmen and the GoA even if it is closer to what is widely acknowledged to be the increase in the cost of living. The GoA will likely seek an annual salary rise of 12-14% for 2008-09, in the 3-5% range above the official

inflation rate.

¶6. (SBU) The day following CFK's inauguration, Moyano (who is in the midst of an intense CGT power struggle) warned the government that he would "jump to the opposition if workers' rights are not respected." In an indication that the GOA takes this threat seriously, ex-President Nestor Kirchner made a public appearance with Moyano on December 19. Key factors here are labor politics. A number of CGT union leaders are vying to replace Moyano as leader of the CGT confederation and the rival CTA union grouping is trying to win government recognition of its status as a union confederation and to woo adherents from the CGT. This mix of labor politics could generate much disruptive strike action: no doubt a factor in the government's thinking.

¶7. (SBU) For its part, big business, led by the powerful Argentine Industrial Union (UIA) has rejected any fixing of prices in Social Pacts, saying that their real raw material and intermediate good input costs are rising significantly faster than official inflation measures. The UIA has also argued that, beyond prices and wages, Social Pacts must incorporate relevant measures for productivity, employment and competitiveness, a concept rejected by organized labor. Some UIA members have also linked their support for Social Pacts to the creation of a new state development bank that could offer state-subsidized long term funding for investment in new capacity. (Argentina's last long-term development bank, BANADES, was liquidated in 1993 due to excessive loan delinquencies. It is alleged that BANADES' lending criteria were based less on conservative credit practices than on political favoritism and patronage.) In her December 10 inaugural address, CFK fired warning shots at both business and labor, saying she had not become President just to defend business profits or to get caught up in trade unions' in-fighting.

Social Pacts: Practical Realities, Aviation Exemplar

¶8. (SBU) Local media reports indicate the GoA is contemplating approximately ten separate Social Pacts covering the key industry and service sectors: Automobiles and auto parts; textiles and clothing; hydrocarbons and minerals; agricultural cereals, processed food and drink; meat and meat processing; chemicals; steel; and

tourism. Energy generation, transmission and distribution and infrastructure (e.g. roads, water, sewage and other public service concessions), sectors already operating with high levels of direct government intervention, would continue to be managed through the Planning Ministry.

¶9. (SBU) Within the GoA, there appears little understanding of just what the nuts and bolts of negotiating social pacts within these individual sectors will entail. In a November conversation with American Chamber of Commerce directors, GoA Labor Minister Tomada frankly admitted he had "no idea" of how sector-specific discussions would be structured or what types of agreements would be developed and signed.

¶10. (SBU) Some local analysts are looking to current GoA-supervised union negotiations with the Spanish-majority owned airline Aerolineas Argentinas for hints as to how the CFK administration will go about negotiating other sector-specific Social Pacts. Aerolineas is Argentina's flag carrier, a chronically strike-prone, inefficient and loss-making airline in which the GoA holds a 5% (soon to be 20%) golden share. Spanish majority investor Marsans is seeking assurances of long-term management/labor peace as a condition precedent to making substantial new investments in planes, hangars, a training center and repair/maintenance centers. Media reports that a draft multi-year Pact is being circulated under which a committee to include the GoA Labor and Planning Ministries, Aerolineas management, and the seven unions that work with Aerolineas (pilots, technicians, navigators, crew, flight attendants, ground personnel, etc.) will be formed. At this point, however, contentious issues of government-regulated ticket prices, union salaries and taxes have yet to be addressed.

Strained Comparison to Spain's 1977 Moncloa Pact

¶11. (SBU) In earlier statements, CFK suggested that proposed Social Pacts would resemble Spain's 1977 Moncloa Pact, an accord designed to stabilize the Spanish economy following Franco's death and during the nation's transition to democracy. The comparison appears a stretch. Prompted by a severe economic crisis, the Moncloa Pact was an agreement among Spanish political parties that laid out a free market consensus and made clear that state interference in the economy would be the exception to the rule and largely limited to social issues. In contrast, the proposed Argentine Social Pacts come on the heels of five years of record economic growth and twin fiscal and trade surpluses, and would be signed by the GoA executive, labor unions and private sector companies and chambers. CFK, who clearly is not interested in sharing any limelight with the fractured political opposition, stopped referring to the Moncloa Pact after pundits pointed out that it was essentially a political agreement that had the buy-in of all major political parties.

Better Comparator: Argentina's Early 1970s Experiment

¶12. (SBU) A more relevant comparator would seem to be the 1973 National Accord Act ("Acta de Compromiso Nacional") signed between the General Confederation of Labor (CGT) and the General Economic Confederation (CGE, a business association) shortly before Juan Domingo Peron assumed the presidency following his return from exile. This pact was structured as a two-year agreement that, after allowing some increase in public utility prices, froze prices of most consumer goods and services. Wages and social benefits were increased across the board and then frozen. The Act explicitly prohibited firms from increasing prices to pass on increased labor costs. The Central Bank was directed to provide below-market loans to companies which sustained financial difficulties due to required wage increases. Finally, a National Commission on Prices, Incomes, and Standard of Living (CONAPRIN) was established with representatives of the GoA, CGT and CGE to guarantee wage purchasing power would not fall below levels prevailing when the pact was signed in case prices (somehow) rose despite the freeze. CONAPRIN was also tasked to monitor business costs and profits to regulate any necessary modifications in wage and price controls, and to link wage increases to productivity gains.

¶13. (SBU) Conditions under which this Social Pact experiment was implemented were hardly auspicious: Argentina's then-small and insular economy was coping with the fallout of extraordinary international economic volatility (the first global energy crisis) and domestic political instability (Peron's death and the assumption of his wife, Isabel Martinez de Peron). Domestic fiscal and monetary policies were dysfunctional: 78% of a 1973 fiscal deficit

that totaled a significant 5.2% of GDP and 88% of a larger 1974 fiscal deficit totaling 5.6% of GDP were financed by monetary emissions. Predictably, the initiative failed to stabilize the economy and resulted in widespread shortages of goods and labor market conflicts. The episode ended with rising inflation, a sharp devaluation, recession and a 1976 military coup.

¶14. (SBU) A number of local analysts also compare CFK's Social Pact initiative with a series of sector-specific "Competitiveness Plans" instituted in 2001 by President De la Rúa's Minister of Economy, Domingo Cavallo. While these competitiveness plans did not include specific wage and price controls, they mandated intricate and distortive sector-specific sets of company benefits and obligations, including productivity requirements and linked tax exemptions. The plan was considered so unworkably complex that the IMF required that it be dismantled as a condition for its final 2003 program agreement.

Comment: Lessons Learned?

¶15. (SBU) Social Pacts appear to be an attractive political construct for the new President, who has promised to build social cohesion and has a political need to address rising public concern with inflation. Local analysts who support the GoA's heterodox

macro and micro policy prescriptions gamely suggest that including fiscal and monetary targets in "new generation" Social Pacts will help them avoid the fate of Argentina's earlier 1970s-era experiment. Ultimately, the success of any modern-day Social Pact will depend on the convergence of interests between business' UIA and labor's CGT. Any such convergence, particularly on wage negotiations, will in turn depend on the GoA's success in restoring the tarnished credibility of official GoA statistics. New Economy Minister Martin Lousteau is expected to attempt to improve INDEC's statistical reporting gradually and in a way that doesn't confront Internal Commerce Secretary (and price control czar) Guillermo Moreno (if such a squaring of the circle is possible). But even with the introduction by INDEC of a new, U.S.-based CPI calculation methodology, this will not be an easy task. Following three years of double-digit inflation, the fear is that Argentina has once again entered a self-sustaining upward spiral of rising prices and rising price expectations: a recent Di Tella University poll put 2008 inflationary expectations at the 22% level.

¶16. (SBU) And, even if the credibility of official GoA inflation statistics is restored, the macro-economic policy base that underpins Argentina's overheated growth rates will likely make it increasingly difficult to control economy-wide inflation over the medium term. Price controls -- here and elsewhere -- are cumbersome mechanisms that encourage evasion and the development of black markets. It is common wisdom in Buenos Aires that the longer a CFK administration takes to apply more "conventional" remedies to address Argentina's growing economic disequilibria, the more costly -- economically and politically -- their correction will be. Social Pacts could be an expensive distraction from the work needed to avoid a hard economic landing.

WAYNE